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Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

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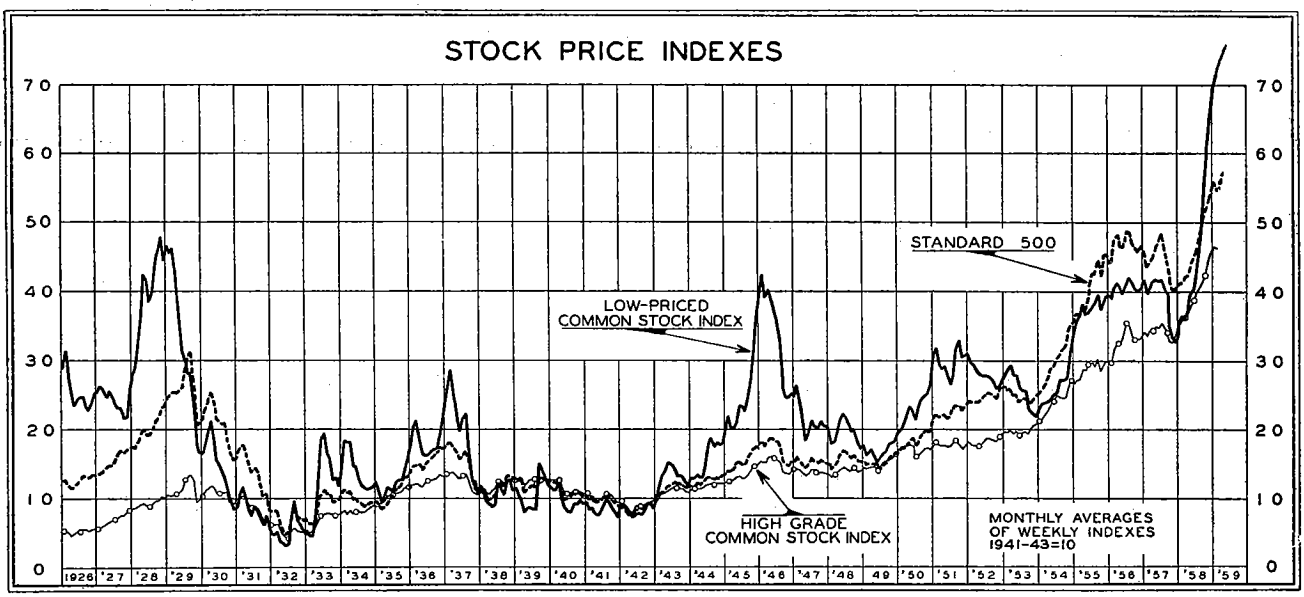
A SPECIAL STUDY OF LOW-PRICED STOCK MOVEMENTS



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THE END? William P. Hamilton taught us that bull markets have three phases. The third and final phase is the "boom," and it is characterized by high volume, wide public participation, and spectacular advances in low-priced "cats-and-dogs." In October, 1957, at the beginning of the third phase of the present bull market, Barron's Low-Priced Stock Index stood at about 115; it is now over 260. In other words, during the last eighteen months this Index has considerably better than doubled. During this same period the investment-grade Dow-Jones Industrials have increased about 50%. The old adage which tells us to "buy good stocks and put 'em away" does not hold true in the third phase of a bull market.

At the time of the July-October, 1957 collapse, it was crucial to judge whether this was the end of the bull market or merely a reaction in a continuing primary bull trend. During the entire period from 1949 (when this bull market began) to late 1957 neither Barron's nor Standard & Poor's Low-Priced Stock Indexes had ever approached their 1929 or 1946 highs (see chart). I maintained that it was not logical in a bull market of this size to have a third phase without the low-priced stock indexes at least bettering their 1946 (let alone 1929) highs. The critical signs of "cat-and-dog" speculation were simply not present prior to July, 1957 (as I stated in an article published in Barron's, December 1, 1958).

THE THIRD PHASE. At the 1929 highs, S & P's 500 Stock Index (representative of the general market) stood at 31.92; it is now 56.98 or about 78% higher. S & P's

Low-Priced Stock Index hit its 1921-29 highs in 1928 when it registered 47.89; it is now 78.63 or about 63% higher. The important thing to realize is that for the first time since this bull market began we are witnessing a third phase boom characterized by great advances in low-priced stocks.

A study of the chart will show that low-priced stocks always make their dramatic advances during the final phase of the bull market. During the 1921-29 bull market, the L-P stocks began their move in late 1927. Two years later the market topped out. During the 1932-37 bull market the big advance in cheap stocks started in late 1936. One year later that market hit its peak and turned down. A giant explosion in L-P stocks market the final phase of the 1942-46 bull market; this move commenced in late 1945. Within a year the end had come. It is obvious that early 1958 provided the springboard for the current boom in L-P stocks, and this advance has already dwarfed every other rise in history.

A little-known fact is that during a bull market third phase, L-P stocks often hit their highs and turn down, following which the investment-grade stocks engage in a final "blow-off" of their own. During 1921-29, for instance, the L-P stock index actually topped-out in late 1928, ten months before the Dow-Jones Averages hit their September 3, 1929 highs.

Many serious investors have asked whether the sky-rocketing L-P stocks on the American Exchange have not absorbed some of the play which might otherwise have been seen on the New York Stock Exchange. This is quite possible but 1) judging by S & P's Low-Priced Stock Index the N. Y. Exchange is doing beautifully on its own, and 2) we may see a great deal more speculation on the N. Y. Exchange before this bull market breathes its last.